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GAO REVIEW OF THE VA HOME LOAN PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND MEMORIAL AFFAIRS

OF THE

COMMITTEE ON VETERANS' AFFAIRS
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

MAY 13, 1987

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GAO REVIEW OF THE VA HOME LOAN GUARANTY PROGRAM

Wednesday, May 13, 1987

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS,
COMMITTEE ON VETERANS' AFFAIRS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 1 p.m., in room 334, Cannon House Office Building, Hon. Marcy Kaptur (chairwoman of the subcommittee) presiding.

Present: Representatives Kaptur, Harris, Patterson, and Smith of New Hampshire.

OPENING STATEMENT OF CHAIRWOMAN MARCY KAPTUR

Miss KAPTUR. The subcommittee will be in order.

Last month, this subcommittee heard testimony from a variety of witnesses on the current operation of the Veterans' Administration Home Loan Guaranty Program. Those witnesses showed tremendous insight in their evaluations, and their recommendations for improvements will be beneficial to us as we formulate legislation.

Although the hearings have demonstrated that this is an effective program which has helped over 12 million veterans achieve the all-American dream of owning a home, its operation is beset by such problems as inadequate staffing levels. This, coupled with the large influx of VA home loan guaranty applications last year, has resulted in a serious deterioration of quality and timeliness in delivery of services.

Additionally, foreclosures continue at a high level, and the payment of claims as well as increased property acquisitions are depleting the VA Loan Guaranty Revolving Fund. Obligations for the month of March of this year alone in the Loan Guaranty Program totaled $311 million, and the Veterans' Administration estimates that a $100 million supplemental appropriation will be required by early summer to keep the program solvent.

It is therefore most appropriate that we hear today from the General Accounting Office on its preliminary findings relating to the examination of the Veterans' Administration Home Loan Guaranty Program.

Your statements, I am sure, will support the views of this committee that increased servicing on loans could result in fewer foreclosures. We also believe that once foreclosure is evident, the Veterans' Administration should try to minimize the cost of acquisition. GAO's analysis is most timely, and I appreciate your appear-

ing before the subcommittee today to discuss your recommendations for reducing costs in the future.

Mr. John Luke, who is the lead witness this afternoon for the GAO, is associate director of the Resources, Community, and Economic Development Division.

We certainly welcome you to the committee this afternoon, Mr. Luke, and thank you for being on time and for having such an excellent statement available for the record.

STATEMENT OF JOHN H. LUKE, ASSOCIATE DIRECTOR, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY: EDWARD KRATZER, AUDITOR; AND DAVID TONER, AUDITOR

Mr. LUKE. Thank you, Madam Chairman. It's our pleasure to be here.

Before getting started, I'd like to introduce two of my colleagues that are with me here today. To my left is Mr. David Toner and to my right Mr. Ed Kratzer, the two principal GAO auditors that directed our effort with respect to the VA Home Loan Guaranty Program.

Miss KAPTUR. Thank you very much.

Mr. LUKE. Again, Madam Chairman and members of the subcommittee, we appreciate this opportunity to provide information on the Veterans' Administration's Home Loan Guaranty Program.

As you are aware, on November 11, 1986, the chairman of the Veterans' Affairs Committee asked us to determine the impact of the Deficit Reduction Act of 1984 on the program, evaluate VA's servicing on defaulted loans, and determine whether VA's property acquisition and disposition process can be improved to reduce program costs. In doing so, it was requested that we pay particular attention to VA's program in Houston, Texas, because of the depressed housing market and the substantial number of VA foreclosures in that area.

In summary, our review to date indicates that VA has reduced its losses, as the Deficit Reduction Act intended, by leaving more properties and potential losses with lenders. However, the debt of the veterans who default on their loans has increased.

The extent of servicing provided to veterans varied among the offices that we visited, and none of the offices voluntarily notified veterans of all the financial assistance options available to cure their defaulted loans. Some offices said they did not have adequate staff to provide effective assistance, and our review shows that VA does not have a system to determine the number of delinquent loans that can be effectively handled by its servicing technicians.

We found that VA can improve its acquisition process and practices to reduce losses by avoiding unnecessary delays in acquiring property, encouraging additional bidding at foreclosure sales, and reducing the costs of obtaining title policies on acquired properties. In fiscal year 1986, VA sold nearly 25,000 acquired properties at a loss of about $356 million.

As I previously mentioned, Houston has a depressed housing market and a substantial number of foreclosures. Nonetheless, we found little evidence that the Houston office has provided adequate

loan servicing to prevent foreclosures. Since January 1987, this office has increased the number of personnel assigned to loan servicing and now believes it will do a better job in assisting veterans to avoid foreclosure.

To accomplish our review objectives, we conducted interviews with loan guaranty officials at seven VA regional offices and VA headquarters. We also reviewed property management and loan servicing records and files and met with Federal Housing Administration officials and mortgage bankers to discuss their foreclosure practices. Before discussing our tentative findings, let me briefly highlight the VA program and its associated foreclosure processes.

As you are aware, the VA Home Loan Guaranty Program was established by the Serviceman's Readjustment Act of 1944 to assist returning veterans in obtaining housing as compensation for the lost opportunity experienced during their period of military service. The VA is authorized to aid the veteran in obtaining a home by requiring no down payment, providing low interest rates, and guaranteeing the home loan. The current amount of the guaranty is limited to the lesser of $27,500 or 60 percent of the loan amount. As of September 30, 1986, VA had guaranteed about 11.8 million home loans since the inception of the program, and about 4.1 million loans were outstanding.

During fiscal year 1986, lenders foreclosed on over 33,000 VA-guaranteed loans. When a veteran defaults on a loan, VA must decide whether to acquire the property. Prior to the Deficit Reduction Act of 1984, VA, in making this decision, was not required to include certain post-acquisition costs, including repairs, maintenance, security, and taxes. The act, however, required VA to include these costs and limit its losses to the guaranty amount.

If VA determines its losses would be more than the guaranty, it simply pays the guaranty and leaves the property with the lender. If VA decides to acquire the property, it attempts to purchase the property for the minimal cost, prepare and list the property for sale as quickly as possible, and sell the property for the best possible price.

Madam Chairwoman, now I'd like to discuss the effects of the Deficit Reduction Act on the program.

Our review shows that the Deficit Reduction Act has resulted in an increase in the debt of the veterans who default on their loans. The veteran's debt is calculated based on the amount of the indebtedness owed the lender minus the estimated net value of the property. Because the act required post-acquisition costs to be included in VA's acquisition decision, the net value of the veteran's property has decreased, resulting in an average increase of $2,700 in the veteran's debt.

The act also resulted in an increase in properties left with lenders. In fiscal year 1986, VA left 5,236 properties with lenders, an increase of 3,735 over the number left in fiscal year 1984.

The results of a Mortgage Bankers Association survey showed that the average loss on properties left with lenders was about $16,500 during fiscal year 1986. Data provided by VA showed that it anticipated transferring an average loss of $3,750 per property that it acquired.

In asking the Mortgage Bankers Association about this difference, we were told that its estimated losses were not based on a scientific sample and included interest costs that VA does not include in its calculation. Further, our analysis of the Association's data showed that the average value of sampled properties included in the survey was about $43,000 higher than the average value of properties on which VA based its estimate. The higher valued properties generally have a greater potential for loss to the lenders because of the limit on the VA's guaranty.

Turning to mortgage servicing, under VA's Home Loan Guaranty Program, mortgage lenders are required to service their VA loans by providing veterans with adequate opportunity to avoid foreclosure. However, the lender reports the delinquency to VA once the veteran has failed to make three payments on the mortgage loan. VA then takes an active role in protecting the financial interests of the veteran and the Government by attempting to cure the delinquency.

We found that the extent of loan servicing varies widely among VA's regional offices. For example, in two of the offices we visited, attempts were made to contact each veteran to determine whether a loan repayment plan could be developed to cure the delinquency. At three of the other offices, however, we were told that the number of staff was inadequate to effectively contact, counsel, and assist the large number of veterans having delinquent loans. The number of delinquent loans handled by servicing technicians at the offices we visited ranged from 400 to 1,500 loans. VA does not have a system to determine the number of delinquent loans that can be effectively handled by its servicing technicians.

According to VA regional officials, they encourage veterans to reach agreement with lenders on how to cure the loans. However, VA usually does not provide information on financial assistance options which VA can provide unless the veteran is aware of and requests information on these options.

VA's financial assistance options include: one, encouraging the lender to reduce the interest rate on the loan; two, refunding the loan; and, three, assisting the veteran to avoid foreclosure by selling the property. We were told by the assistant director for loan management that VA has not informed veterans of the latter two options because they may not attempt to cure their loans by reaching repayment agreements with the mortgage lenders.

Many of VA's delinquent loans were made during the high interest rate period of 1982 to 1984. Therefore, an option that VA can sometimes use to cure loans is to encourage the lender to refinance the loans at lower interest rates. Refinancing would provide some veterans with a lower monthly payment, thus increasing their likelihood of staying in the home. However, the VA is not contacting all veterans with delinquent loans to make an assessment on the feasibility of refinancing. Accordingly, this option is not being fully utilized.

When lenders will not refinance delinquent loans, VA may pay the lender the outstanding loan amount as an option to foreclosure, enabling the veteran to keep the property. VA then refunds the loan and establishes a repayment plan based on the veteran's ability to repay the loan. In effect, VA assumes the role of the lender.

The average cost avoidance possible through refunding in fiscal year 1986 was approximately $14,400 per property. This is based on the average amount of loss that VA incurred on the sale of acquired properties. Our analysis shows that the cost avoidance from one successful refunded loan would be sufficient to offset the additional foreclosure costs to refund six loans that subsequently fail.

According to VA's assistant director of loan management, refunding has been successful in about 50 percent of the cases in which it has been used. Nonetheless, during fiscal year 1986, VA refunded only one mortgage for every 129 foreclosures.

As an alternative to foreclosure, veterans may sell their homes and pay their outstanding loan balances. However, they sometimes need financial assistance to do this because the proceeds from the sale are not adequate to pay both the outstanding loan balance and the selling expenses.

VA has a program under which it may provide, in exchange for a promissory note from the veteran, the financial assistance necessary to enable the veteran to sell the property. VA provides this assistance when it believes it is cost-effective to do so because the veteran can obtain the fair market value for the property and VA can avoid foreclosure costs. Again, however, VA does not generally inform veterans that this option is available to them.

Turning to the acquisition and disposition process, when VA decides that it is in the best interests of the Government to acquire a property, it should minimize its acquisition costs. In fiscal year 1986, VA lost an average of about $14,400 on the properties it sold. Our review indicates that VA can reduce its losses by seeking to obtain more voluntary deeds from veterans in lieu of lengthy and expensive foreclosure actions, encouraging more competitive third-party bidding at foreclosure sales, and reducing its costs for title insurance policies when it acquires properties from lenders.

Voluntary deed conveyance is an expeditious means of terminating a delinquent loan. The veteran voluntarily conveys the property deed and is released from liability to repay the Government for any claim VA pays as a result of the loan termination. In so doing, the foreclosure process is avoided and VA is able to acquire the property more quickly and avoid costs, including interest, taxes, and legal expenses.

In fiscal year 1985, VA acquired about 7 percent of its properties by voluntary deed. A report issued in September 1986 by the VA inspector general estimated that by more aggressively seeking deeds in lieu of foreclosure VA could have acquired about 20 percent of the properties through voluntary deeds during fiscal year 1985. The inspector general estimated that this would have saved VA about $16 million in acquisition costs or about $5,300 per property.

We found that VA acquired only about 6 percent of properties through voluntary deeds during fiscal year 1986. In performing our review, we noted that VA generally does not accept a voluntary deed if it believes that it can collect from the veteran the amount of the claim VA pays the lender as a result of the loan termination. However, at one of the offices we visited, voluntary deeds were accepted if veterans were willing to sign a promissory note to repay the claim. VA should determine whether it is feasible to use

this practice in other offices as a means for reducing the debt of the veteran and avoiding considerable expenses associated with the foreclosure process.

Regarding third-party bidding, VA's acquisition costs could potentially be reduced if more third parties made successful bids at foreclosure sales. When third parties purchase the property, VA pays the lender the difference between the total indebtedness and the bid price and avoids both acquisition and post-acquisition costs. We noted, however, that only about 5 percent of foreclosed properties were acquired by third parties during fiscal year 1986.

To increase third-party bidding, VA could establish a minimum bid amount that reflects the net amount that VA expects to realize on the sale of property. We found that the minimum bid amount often exceeds the net amount VA realizes when it sells the property. This difference could be factored into each office's determination of the minimum bid amount to encourage third-party bidding.

When VA acquires property, it requires lenders to provide it with assurance of good and marketable title to the property. In April 1986, VA instructed its field offices to obtain title insurance policies from title companies rather than continuing to analyze title documentation to assure that lenders were providing good and marketable title.

VA decided to obtain title insurance policies, which generally cost several hundred dollars each, because it believed their use would expedite the property acquisition process. Based on our review, however, title policies have not reduced the time needed to complete the acquisition process. Now VA officials are considering eliminating the requirement for title insurance policies since they are not achieving their anticipated purpose of expediting the property acquisition process.

We concur with VA's decision to reconsider whether to require the purchase of title policies. Further, in the event that VA decides to continue purchasing these policies, it could still reduce its costs by purchasing them for the lowest possible price. For example, the minimum title policy in Pennsylvania costs $263 for $15,000 worth of insurance. However, in fiscal year 1986, we found VA to be insuring the average property in Pennsylvania for about $27,000, the appraised value of the property, at a cost of $353 per property.

As I noted earlier, we were asked to review VA's response to the depressed housing market in the Houston area. As you are aware, this area suffers from unemployment due to cutbacks in the oil industry, a high home vacancy rate, and a foreclosure rate among the highest in the country. In fiscal year 1984, before the Deficit Reduction Act took effect, the Houston office handled 1,944 foreclosures, leaving only 4 properties with lenders. In contrast, in fiscal year 1986, that office handled over 5,600 foreclosures, leaving nearly 1,100 of the properties with lenders.

Our review showed that some of these properties were left with lenders because VA's Houston office, for a period of eight months in 1986, adjusted upward the calculation that VA uses throughout the country to decide whether to acquire the property. The adjusted calculation increased VA's estimate of its cost to reflect declining property values in Houston. VA's estimate of its costs was in-

creased by an average of $2,225 per property during that eight-month period.

The adjustment also increased the debt of the veterans who lost their homes because their debt is based on VA's property acquisition calculation. On the basis of our analysis of VA's data, the average debt was increased by an estimated 22 percent, from about $9,900 to $12,100 on properties acquired by VA.

In an attempt to determine the impact of Houston's adjusted calculation on mortgage lenders, we analyzed the 135 properties left with lenders during a two-week period in 1986. We found that 37 of these properties, or over 27 percent, would have been acquired by VA if the calculation had not been adjusted upward for that eight-month period. In October 1986, VA headquarters instructed the Houston office to resume using the national calculation in making acquisition decisions.

Because of the difficulty in selling its large inventory of acquired properties, the Houston office used auction sales to sell property that had been in its inventory for more than a year. During 1986, the office used three auction sales to dispose of property at substantial losses. For example, in one of the auctions, the average property was sold for 44 percent of VA's initial sales price.

While this method of disposing of inventories may have achieved VA's goal of reducing the number of properties in the inventory, the Mortgage Bankers Association told us it is concerned about the effect of VA auctions on home values in the Houston area. VA's assistant director for property management told us that VA plans to continue using auction sales to effectively compete in selling property in the Houston area.

We also noted that competition between VA and FHA may be influencing the decline of property values because these agencies collectively hold over 10,000 foreclosed properties in the Houston market area. During 1986, VA lowered its prices by 10 percent to compete with FHA's prices. FHA responded by lowering its prices by another 10 percent, and, at the time of our review, VA was considering once again lowering its prices in response to FHA's reduction.

We also reviewed the servicing performed by the Houston office and found little evidence that it had provided financial counseling and assistance to prevent foreclosures. In the last quarter of fiscal year 1986, the Houston office had made personal contact with less than 28 percent of the homeowners involved in the foreclosure process for that quarter. Further, the Houston office refunded only 7 loans while lenders foreclosed on more than 5,600 mortgages during fiscal year 1986.

In January 1987, VA approved 10 additional staff members for the Houston Loan Guaranty Division. Three of these staff members were assigned to loan servicing, doubling the number of servicing technicians at the office. According to the loan servicing chief in Houston, the office will now be able to do a better job of assisting veterans to keep their property. She said, however, that an additional three staff members are still needed to effectively service the office's delinquent loans.

Nonetheless, we noted that the office is making progress in providing financial assistance. Since October 1986, it has refunded 4

loans and is in the process of refunding 28 loans. The director of the Houston office told us that with the additional staff members that have been assigned the office can now encourage refunding as an option to foreclosure.

In closing, Madam Chairwoman, I would like to reemphasize that VA's Home Loan Guaranty Program is experiencing a large number of foreclosures, as you are well aware. The foreclosure process is costly for VA, the veteran, and sometimes the lender, particularly in depressed housing markets.

Since the Deficit Reduction Act of 1984 has been implemented, VA appears to have accomplished the broad intent of the act by minimizing its losses within the guaranty amount. However, this has increased the debt of veterans who default on their loans and the losses of lenders who participate in the program. To help reduce these costs, more emphasis should be placed on servicing to prevent foreclosures. Once foreclosure is evident, VA should try to minimize the cost of acquisition.

Madam Chairwoman, I have highlighted today some areas in which VA can improve its Home Loan Guaranty Program based on our preliminary findings. We are planning to complete our work and issue a report to the chairman of the House Veterans' Affairs Committee containing our conclusions on the areas we have discussed here today.

That concludes my prepared statement, and I would be pleased to answer any questions that you may have at this time.

[The statement of Mr. Luke appears at p. 23.]

Miss KAPTUR. Thank you, Mr. Luke. I think you have provided a real service to this committee, to the subcommittee and the full committee, and I'm wondering if in that final report you are going to issue if you could make an effort to total, if the VA adopted several of the recommendations that were included in your testimony, the total amount that we could save to the Federal Government. I notice in the refunding proposal you had an estimate, but there were some other ones there. I would sure appreciate it if you might make a projection when you send that over.

Mr. LUKE. Given the data set that we have, to the extent that we can, we will certainly make an effort to do that.

Miss KAPTUR. All right.

As you went through your study and you went around to these various offices, why weren't some of these obvious procedures adopted already, for example, the refunding? Is it just that they hadn't thought of it or avoided it as a cost saving measure? Where is the problem in the chain of command?

Mr. LUKE. As I indicated earlier, VA's first line of defense is to encourage the lender to work out agreements with the borrower, to cure the delinquent loans. VA views itself as a stopgap or a second line of defense to prevent foreclosure after the lenders' efforts have not succeeded. Two of the programs that VA could use are refunding and compromise assistance sales.

Also, in a number of areas that we visited, some of the regional offices are, in fact, taking advantage of some of these opportunities. But to do that, they physically have to make contact with veterans to figure out what their needs are.

Miss KAPTUR. Now you have stated in your testimony that the VA does not have an adequate servicing program. Do you think that is the result of not having enough staff or just that procedures haven't been set in place at some level to see that that happens? You mentioned the first line of defense was the lending institutions then the VA. Is it a staffing problem, or is it a procedure problem?

Mr. LUKE. Probably some of both. The situation in Houston clearly looks like a staffing problem. With respect to some of the other areas, it appears to be a philosophical approach to doing business, because there are procedures and guidelines that can be implemented; it's left to just the preference of VA as to when they are implemented and how they are implemented.

As I indicated in my statement, VA does not make a practice of making available to veterans what other options are available to them with respect to some of these activities. If it did more of that, maybe it could get more of these things on line and operative to resolve some of these probleMiss

Miss KAPTUR. You stated in your testimony that the number of delinquent loans handled by servicing technicians ranged from 400 to 1,500 loans. From your research, what do you think would be the required elements of a reasonable servicing program?

Mr. LUKE. That's a very good question. I thought you were going to ask for a specific number, and I'm glad you didn't. It would be a difficult question to deal with.

Miss KAPTUR. You can give us one, if you want.

Mr. LUKE. I wish I could.

But, clearly, in terms of an effective servicing system, adequate staff would be one of those elements. I mean you have to have people to do the work to figure out exactly what the needs of the vets are in terms of what kind of problems are being experienced and what kind of agreements can be worked out. So, off the top, I would say good quality, trained servicers is a required element.

Another element would be initial contact, or early contact, with the veteran having a delinquent or defaulted loan, because, history has shown that the earlier the contact the greater the likelihood of being able to work these things out.

Miss KAPTUR. Do you know enough about it to know when that happens in the system? At what point does the VA become aware? Does the bank contact them. Where does that linkage happen?

Mr. LUKE. The bank is required to contact the VA after the vet has missed three payments. So contact is made anywhere from 60 to 90 days down the road.

Is that right, Dave?

Mr. TONER. It's between the 60th and 105th day after default. What we are finding is that usually the lender comes in at the tail end rather than the early part in order to cut down on his paperwork.

Miss KAPTUR. You have lost all that time, if you are trying to help the veteran, even in the refinancing area. It sort of comes in at the end of the process rather than the beginning, doesn't it? If you wanted to try to help the veteran more, you would try to intervene earlier, wouldn't you?

Mr. LUKE. Yes, and, again, the earlier you can, the better off you are because you increase the likelihood of curing it.

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One other, I think, important variable in the context of the question raised would be sustained contact over time, because some of the problems, particularly in terms of refinancing and refunding, take time, so you just can't make contact with veterans and then leave them alone. You have to be about the business of continuous interaction with the vet.

Miss KAPTUR. On a scale of one to ten, one being the best, how would you grade the VA in its effectiveness in servicing and reducing losses and foreclosures?

Mr. LUKE. Well—

Miss KAPTUR. I'll ask you for a judgment call.

Mr. TONER. It depends on the office.

Miss KAPTUR. The regional office?

Mr. TONER. Yes.

Miss KAPTUR. Are there some that are really good?

Mr. TONER. We would like to say yes. From my interaction with some offices, I'm very much impressed with their operation.

Miss KAPTUR. What makes the difference?

Mr. TONER. Contact. You have to contact the vet to work out the repayment plan, and also to take a strong position with the lenders, to work out repayment plans with them.

One of the problems that we have noted in the system is that there is a lack of evaluation of the effectiveness of servicing. You cannot tell what servicing has done.

Miss KAPTUR. You visited seven offices?

Mr. TONER. Yes, Ma'am.

Miss KAPTUR. Of those that you visited, did most of them have personal contacts with veterans who had delinquent loans, or was it the exception rather than the rule?

Mr. TONER. Most of them did have contact.

Miss KAPTUR. Did?

Mr. TONER. Yes.

Miss KAPTUR. Do you know what the cure rate is for regional offices which have higher servicing standards? How successful are they?

Mr. LUKE. Clearly, based on the data that we have seen, there appeared to be a positive correlation between high contact and high cure rate.

Miss KAPTUR. Really?

Mr. LUKE. And in those regions that had fairly high personal contact, the cure rates were noticeably higher than those that did not.

Miss KAPTUR. Did any office particularly impress you in the whole system?

Mr. LUKE. Well, based on the numbers that we have, I think in Philadelphia, in terms of cure rate, the rate of 8.1 to 1, and in terms of personal contact, it was up around 85/86 percent.

Miss KAPTUR. I have some additional questions, but I would like to move on to other committee members and then come back to myself.

Mr. Smith from New Hampshire.

Mr. SMITH OF NEW HAMPSHIRE. Thank you, Madam Chairman.

I apologize for coming in late and trying to catch up—listen to you and read what you already had said.

Having been in the real estate profession before coming to Congress, I guess I'm somewhat shocked at the amount of loss, $356 million on 25,000 acquired properties. How much is being done to encourage bidding on the properties when we have that unfortunate circumstance where we do have to foreclose and when the Government does acquire the property?

You alluded to it a few minutes ago in your testimony, Mr. Luke, but I'm just curious: Do we really make an attempt to find people who would be willing to bid on those properties? It seems to me that—I'm asking a lot of questions in one here—but it seems to me that, given the current real estate market in the country, we ought to be able to get out of those properties at least at cost without a loss. It just seems like we should be able to, when you figure the amount of the mortgage and the costs of disposition of the property.

Still, encouraging the right type of bidders to come in, or at least qualified buyers to come forth, it seems to me we ought to be able to get, if not a profit out of it, at least—

Mr. LUKE. Costs.

Mr. SMITH OF NEW HAMPSHIRE. Costs.

Mr. LUKE. Right.

Mr. SMITH OF NEW HAMPSHIRE. Explain to me why we can't.

Mr. LUKE. I don't know whether I can explain to you, Congressman Smith, fully why we can't. third-party bidding is an option VA has with respect to disposing of properties prior to incurring a number of foreclosure costs. The earlier you can get out of the foreclosure process, the more apt you are to save money, and third-party bidding is one way to avoid the foreclosure process.

I think the numbers indicate that VA used third-party bidding around 6 percent of the time?

Mr. TONER. It's 5 percent.

Mr. LUKE. Five percent. And, again, at the risk of passing judgment on VA, the use of these tools seems to be a passive kind of behavior versus an active kind of behavior.

One of the problems with third-party bidding was the pricing in terms of the minimum bid amount established by VA. VA's minimum bid amount routinely was much higher than the net amount VA realized when it sold the property. To the extent you can get those amounts closer, you increase the likelihood of having more bidders. The more bidders, the more apt you are to move more properties and increase the likelihood of reducing losses. That's what we would encourage.

Mr. SMITH OF NEW HAMPSHIRE. As a follow-up to that, normally, when the lending institution is the only one involved, their interest, obviously, is only to get out what their costs are, and I've seen cases where simply if they can get one bidder to do that, they are pleased; they just want to get out.

It just seems to me that, given the normal equity that is built up as property improves in value, it just amazes me that we can't recover more. I still don't understand why.

Mr. LUKE. I should say—and, Dave, you can help me here—that with respect to many of these properties, they are not likely to be in markets of high appreciation.

Mr. SMITH OF NEW HAMPSHIRE. Okay.

Mr. LUKE. And, many of the properties that VA acquires actually are losing value in a depressed housing market.

Mr. SMITH OF NEW HAMPSHIRE. Just one other question, Madam Chairman.

Just as a point of information, say, a typical veteran who is in this unfortunate situation where he or she is behind in payments, what is the attitude? Is it one of, "The heck with it; I can't do it; I'm going to walk away," or is there really a genuine effort on the part of the veteran in cooperation with the Veterans' Administration to recover?

Mr. LUKE. Dave, do you want to help? You've spent some time in the field.

Mr. TONER. It's really a mixed bag out there. There are a number of veterans that definitely want to be helped and have made numerous contacts with the Veterans' Administration to seek that help. Others seem to have an indifferent attitude, and why that is is very difficult to understand, especially when you consider the fact that the vet will incur a debt if, in fact, he goes to foreclosure.

Mr. SMITH OF NEW HAMPSHIRE. Is there a reasonable attempt to stay on top of these things so that we can have some idea, perhaps, before the third or fourth month of delinquency that the guy is in trouble? Is there some monitoring that is done on this? By that time, it is too late usually.

Mr. TONER. Yes. One of the problems in the system is that lenders have just about decided to foreclose before notifying the VA in between the 60th and 105th day of delinquencies. What they are doing is notifying VA at the tail end of the cycle when they are ready to start the foreclosure process. That delay probably decreases the likelihood of working out something with the vet.

Mr. SMITH OF NEW HAMPSHIRE. I missed your point. The delay does what now?

Mr. TONER. Well, it decreases the possibility of the Veterans' Administration working out something, because by the time the Veterans' Administration gets into it, it is 4 to 5 months delinquent.

Mr. SMITH OF NEW HAMPSHIRE. Okay. I follow you.

Now regarding the lending institutions in terms of rewriting loans at lower interest rates, I notice in your testimony you indicate that sometimes they do and sometimes they don't. Can't we be a little more aggressive in that regard? It seems to me very prevalent today—at least, it has been the last couple of years—to rewrite a mortgage. I mean everyone goes down: There's a lower interest rate, so rewrite your mortgage.

Mr. LUKE. Right.

Mr. SMITH OF NEW HAMPSHIRE. And here we are hearing in this testimony that there are lending institutions out there that are not doing this for our veterans. Why? An average citizen who is not a veteran can do it, and sometimes they have been encouraged to do it by advertising and so forth.

Mr. LUKE. As a result of your experience in the real estate market and dealing with mortgage bankers, I'm sure you are aware that the banking institutions, when they make loans for real estate, do not do that with the expectation of holding that mortgage. They do that with the expectation of selling that mortgage at

some point in time, either to a Ginnie Mae pool or in the private market. They are not willing to carry the loan in their own portfolio. It limits their opportunities.

It is our understanding with respect to the VA loans and the Ginnie Mae pool that Ginnie Mae requires the lenders to get an appraisal on the VA's properties if the refinancing amount is higher than the obligation amount. What you find in terms of the reappraisal is that, particularly in depressed and declining markets, the debt amount exceeds the value of the property, and in those cases it is not possible to sell the loans into the Ginnie Mae pool.

So if, in fact, a lender makes that kind of loan, what it is saying at that point in time is, "I must hold this loan," and how much of that they are willing to do is probably reflected in their behavior of not refinancing.

Mr. SMITH OF NEW HAMPSHIRE. Well, thank you.

Thank you, Madam Chairman.

Miss KAPTUR. Following on Mr. Smith's excellent line of questioning, I wanted to refer to page 15 of your testimony where you do have one of these examples cited of a decision to leave the property with the lender and pay the guaranty amount. This obviously was a situation where the bank, for whatever reason, had chosen not to refinance or some opportunity had been lost, and I'm wondering if one of you could walk us through exactly what this chart means. We are somewhat confused about the total indebtedness of $93,900, the appraised value at $70,000. That's a $23,000 difference there.

I guess I'm sitting here and thinking, if the bank ate a little bit of the loss and the Government ate a little bit of the loss—why should the Government lose the whole guaranty amount here? I'm wondering what kind of insights you might have gained by going out there and looking at some of these figures as to where there might be some movement we could put into the system so that we wouldn't be paying out all these guaranties and whether it's an appraisal problem. Could you explain a little bit about how this chart relates to what Mr. Smith was talking about?

Mr. LUKE. Sure.

Miss KAPTUR. This is an example of that, is it not?

Mr. LUKE. It is certainly an example in terms of VA going through its decision-making process and its behavior in accordance with the Deficit Reduction Act of making no bid determinations.

The $93,900 was the total indebtedness of the vet at that point in time. The appraised value of $70,000 is the appraised value at the time of foreclosure. Now the difference, in part, is a function of interest, accruals, back taxes, and so forth.

Miss KAPTUR. That's pretty high, isn't it?

Mr. LUKE. There are a number of things considered.

Dave?

Mr. TONER. Well, our analysis showed that the average property value decreased by about $10,000.

Miss KAPTUR. $10,000 is the average.

Mr. TONER. Was the average.

Miss KAPTUR. So this is way above.

Mr. TONER. Right. The remainder of the difference reflects the fact that it takes an average of about 12 months to foreclose, so you are running about 12 months of interest and taxes.

Mr. SMITH OF NEW HAMPSHIRE. Would the gentlelady yield?

Miss KAPTUR. Go right ahead. I yield to the gentleman.

Mr. SMITH OF NEW HAMPSHIRE. A point in my own experience I had seen was that frequently the foreclosure appraisal, in the interest of trying to dispose of the property, is not always quite in line with the mortgage appraisal. I'm not casting any bad light on the banking industry, but, seriously, I don't know what the policy is in terms of getting a second opinion on some of these appraisals. Usually it's a couple of opinions or perhaps three, and you take the average. I don't know whether that is the policy of the VA or not, but it might be something to look into if it isn't. I don't think that the bank appraisal in regard to a foreclosure is necessarily the fair market value of the property.

Mr. TONER. This is the VA's appraisal of the property.

Mr. SMITH OF NEW HAMPSHIRE. Pardon me?

Mr. TONER. This is the Veterans' Administration appraisal of the property. They have an independent appraiser identify the value.

Mr. SMITH OF NEW HAMPSHIRE. On the foreclosure?

Mr. TONER. On the foreclosure, and they also review the appraisal to assure that they feel it is adequate.

Miss KAPTUR. Let me just say for the record that, based on other testimony that we have had here, the whole appraisal procedure used by the VA and some of the individuals that were used out in the country was not the best system in the world, and we are looking in our bill to strengthening and working with the inter-agency task force on appraisals so that we don't get the kind of variation that you are talking about. There was a lot of questionable activity going on out there.

So, although maybe you have seen VA in the new iteration after January of this year, there were some horror stories the year before and the year prior to that. I don't know what year these figures represent, but we had some real problems, because we don't license appraisers as a Nation, there are no set standards, and we are moving with HUD and various associations to try to standardize and to require VA to actually have an approved appraiser list so that we don't run into this problem again.

We did have some real problems with appraisers. In fact, Congressman Barnard in Government Operations had quite a set of hearings on this very topic. So I think the problem you have put your finger on is one that has proven to be true.

Mr. LUKE. Madam Chairwoman, did we adequately respond to your concerns in terms of the difference between the $93,900 and the $70,000?

Miss KAPTUR. As best as you can, I guess. I'm not really pleased to see that the lender absorbs $3,000—$5,700 in loss and the Government picks up $27,500, and that there are no efforts made for refunding or servicing to the veteran. Yes, we get their money back.

But one of the things I was going to ask in general, not only on this issue but on some of the other ones that we are going to get into, is, when you do your final report to the committee, if you

could be so kind as to make recommendations not only on administrative changes that you think would be helpful to address the problems outlined but also legislative changes, because we are certainly looking at a housing bill for this year, and we are right in the process of putting ideas together. So your study and knowledge by going out in the field could really be very helpful to us. We welcome those.

Mr. LUKE. And we will certainly try to be responsive.

Miss KAPTUR. All right.

Mr. SMITH OF NEW HAMPSHIRE. Madam Chairman, may I ask one more question?

Miss KAPTUR. Go right ahead.

Mr. SMITH OF NEW HAMPSHIRE. I apologize to you for interrupting.

Is there an attempt made once this foreclosure sale is imminent to list the property on the active market at a certain price prior to the foreclosure? Is there any attempt to do that? Sometimes you can avoid the whole foreclosure by getting a buyer and a seller.

Mr. LUKE. Have we?

Mr. TONER. The basic policy of the VA is, let the vet work out his own sale of the property. If the vet thinks he can recover the total indebtedness, he will go out and try to sell his property rather than go to foreclosure.

Mr. LUKE. But also, if I understand the question, part of it is, during the foreclosure process, is there an attempt to advertise or list the property?

Mr. SMITH OF NEW HAMPSHIRE. Well, foreclosure is normally advertised.

Mr. LUKE. Right.

Mr. SMITH OF NEW HAMPSHIRE. A foreclosure sale is advertised, obviously; it has to be by law; and once it is advertised, I have seen—and I can't say that I've seen it with veterans—but I've seen it with private foreclosures, where the individual, sometimes the bank, but usually the individual, will go ahead and try to sell the property to beat the foreclosure with the bank's concurrence, because, obviously, every day that you cut off the length of the foreclosure, the sale would save some dollars.

It would just seem to me, if you could get a couple of local realtors interested in moving the property, it would alleviate this. I just wondered whether there was any attempt to do that. I know it works frequently in the private situation, but I don't know if you have got any laws against this at the moment or not.

Mr. TONER. The VA does have a program like the one that you are describing—the Compromise Sales Assistance Program. That is one of the things that we are talking about in our testimony, but information on VA's program is not getting out to the veteran.

Mr. SMITH OF NEW HAMPSHIRE. Okay. I understand. Thank you.

Miss KAPTUR. Thank you.

I'm going to call on Members in the order in which they came in.

Mrs. Patterson.

Mrs. PATTERSON. Thank you, Madam Chairman. It's sort of nice that the lady was before the gentleman here. I wasn't the last to come in.

Excuse me for being late, but I appreciate having the opportunity to read your statement as you went along, and I do have some questions.

I guess the loan servicing question is what bothers me the most. It seems to vary from regional office to regional office, and I'm wondering if, when you visited around, you found out of the VA has any uniform guidelines for the regional offices to use about servicing, and, if they don't have any uniform guidelines, did you all talk with any of the people in the VA's central office about the variance in the different offices?

Mr. TONER. The VA has considerable guidance that they provide to the regional office about servicing. One thing about the VA system, it was structured to interact with the vet throughout the foreclosure process. It is how it operates at the local level that becomes the problem. There is guidance for the local level to follow to develop repayment plans, do refunding, and so forth. But how it is being carried out leaves a little to be desired.

Mrs. PATTERSON. So it is sort of up to the interpretation of the regional offices?

Mr. TONER. Yes.

Mrs. PATTERSON. It just seemed to me, when you talked about the success of the Philadelphia area and then what we talked about in Houston, there's such a wide variance. What I want to ask you about the Houston office is, did you notice how they determined—I think you said 20 percent of the homeowners who were involved in foreclosure had some sort of personal contact. Could you tell which ones they decided to have? Were they giving priorities to certain cases?

Mr. TONER. It is our understanding that this contact was, for the most part, initiated by the veteran rather than the VA actively going out and trying to contact a veteran.

Mrs. PATTERSON. So the ones who needed the most help, of course, didn't know to come or didn't feel comfortable coming and therefore were involved in foreclosure.

Mr. LUKE. And, if I may add, some veterans may not have had a sense of the available services that the VA has to offer to help prevent foreclosure.

Mrs. PATTERSON. It seems to me that there is some sort of weakness then with the loan servicing, and I hope we will address that.

Thank you, Madam Chairman. At this time, that would be all the questions that I would have.

Miss KAPTUR. Thank you very much, Mrs. Patterson. We certainly do intend to address it, and we are looking for all ideas members of the committee wish to contribute in how we might strengthen the servicing aspect of the VA Home Loan Guaranty Program.

Mr. Harris.

Mr. HARRIS. Thank you, Madam Chairman.

Mr. Luke, I too want to apologize. It just gets hard sometimes to spread yourself around as thin as we are evidently expected to be.

But I'm troubled: I thought the Veterans' Administration was supposed to be in there to help the veteran, and if we are so tied down with paperwork in the initial loan that we don't have time to service them, that really troubles me, especially when you see the number of houses or homes that are sold at such a low price.

I know this is a preliminary report and that you will have a final report to give to us. I just want to compliment you for the work you have done and to help this committee in trying to come to some conclusions on how to help the veterans. They deserve our support and understanding. I thought that was the whole purpose of the program, not just to put them in a house and leave them out to dry.

In looking at the different offices that you went to, did you find that the staffing was so tied down with the initial loan applications or whatever that they didn't have time to service the loans after they were once made?

Mr. LUKE. We visited some seven of these regional offices, and there was some of that—paperwork, data entry, and trade-offs with respect to other requirements that they saw were of some importance. Servicing may have been put on the back burner. In some areas loans are serviced through field visits and there is little time to handle the backlog of delinquencies with the small number of staff available to VA.

Speaking of spreading yourself thin, not only are you thin but you are making trade-offs in terms of what is important to do. In some of those instances, I may have chosen to do something different than what they chose to do in terms of establishing priorities.

But we certainly hear you in terms of your concern. Not only do we hear you, we share your concerns, because we too are very, very strong proponents of loan servicing. We think that is the key to preventing some of these foreclosures and increasing the cure rate. You just have to get out, make the contact, and make sure the vet is aware and has some sense of what services you have available to assist them in their particular situation.

Dave, do you want to add anything in terms of what we see in the field?

Mr. TONER. There were other trade-offs in the field between loan origination, loan servicing, and property management. Loan origination got a big play in early 1986 because of the tremendous amount of refinancing, because of the interest rate drop. So a lot of VA people had to be involved in that process, and that left fewer people for loan servicing.

Mr. HARRIS. Let me ask you this. As to the auction sales, are you telling the committee that you think that is one system that we need to stop as far as the VA is concerned with selling the houses, or whether you think that is just not a good idea in Houston? I know from past experience in watching sales at courthouses sometimes, it didn't always appear to me that we got the best price, and I'm troubled about this.

Mr. LUKE. Well, generally, that is what you have got when you go to auction, the worst price. The VA auction program, as we understand it, is a last resort program throughout the country and also, as we understand it, in Houston.

With respect to the auction sales program, I think it is appropriate to mention that the large build-up in foreclosures, delinquencies, and VA's inventory and the need to get rid of inventory doesn't appear to be a national phenomenon in terms of the data that we have seen. You can put your hands on some five or ten area offices, and some five to nine States where foreclosures and

the rapid build-up in the inventory presents a problem. So auction sales don't seem to be a problem from a national perspective.

Within Houston, it presents another problem, and, as I indicated, the VA considers it a last resort kind of a program. It is another avenue that is available to VA to reduce its inventory cost.

Ed, Dave, do you have anything to add on the auctions?

Mr. TONER. No.

Mr. KRATZER. No.

Mr. HARRIS. Well, is that something that is done after they have had it on the market for a while and couldn't sell it?

Mr. LUKE. Generally, the properties that the VA has been auctioning, particularly in Houston, have been in the inventory for some period of time, over a year or more.

Mr. HARRIS. Thank you, Madam Chairman.

Miss KAPTUR. Thank you, Mr. Harris.

I wanted to ask you, Mr. Luke, how much refunding would it be reasonable for the Veterans' Administration to do, in your opinion, and do you have any idea of what the budgetary effect on the revolving fund would be?

Mr. LUKE. We haven't done an independent analysis of how much is enough, but I can give you some comparison with respect to the HUD program. HUD has a similar program to the refunding program, and, on average, it is refunding about 10 percent of defaulted loans. If you were to look at a 10 percent figure on the VA side with some 28,000 properties in its inventory, that gives you a figure of roughly 2,800 properties.

Miss KAPTUR. And right now, it is 1 percent? How much was it now, from your testimony?

Mr. LUKE. Ten—

Miss KAPTUR. You are recommending 10, but what is it now? Is it about 1 percent?

Mr. TONER. Two-tenths of 1 percent.

Mr. LUKE. Two-tenths of 1 percent.

Miss KAPTUR. Two-tenths?

Mr. LUKE. Right.

As I was indicating, HUD does roughly 10 percent. Now if you were to bring that over to the VA side, just in terms of some comparison, that would equate to roughly 2,800 properties a year. At the average acquisition cost of roughly $50,000, it would cost $150 million to refund the 2,800 properties. That is an immediate cash outlay required to do that amount of refunding, and that certainly has a budgetary impact.

Miss KAPTUR. In the long run, we would begin saving money.

Mr. LUKE. Yes.

Miss KAPTUR. A lot of money.

Mr. LUKE. Right.

Miss KAPTUR. You state that the VA has a program under which it may provide the financial assistance necessary to enable the veteran to sell his or her property. Could you explain this procedure to the subcommittee, please?

Mr. LUKE. Yes. This is a new program, and it seems as if only Mr. Toner has turned this program up, so I'm going to let him explain how it works.

Mr. TONER. In December 1984, the central office of the Veterans' Administration sent out a memo to its field offices telling about the program called the compromise sale program. Under this program VA will consider cash offers that the veteran could obtain for his property that are less than the full indebtedness associated with the mortgage, so that a vet could sell his house even though he would not get a return on that property adequate to recover the indebtedness. The veteran could write a promissory note to the VA to cover the difference between that indebtedness and what the veteran gets for the property.

Miss KAPTUR. It is not being used very extensively.

Mr. TONER. The Veterans' Administration could not give us any figures on the number of times the program is being used. They did point out that the Los Angeles office seems to be using it very effectively.

Miss KAPTUR. Okay. Is the private sector doing anything to assist defaulted home owners when the mortgage is insured by a private mortgage insurance company?

Mr. LUKE. Yes. Certainly recently, the private sector has begun an aggressive outreach program. Included in that outreach program is financial counseling and minimizing the hurdles associated with refinancing. Also, the private sector assists homeowners to sell their losses to avoid foreclosure.

If you look at the delinquency and the default rates of the private sector and VA, it would suggest that the private sector is doing something differently than VA, because the delinquency or default rate is around 3.5/4 percent, whereas on the VA side we are talking in the neighborhood of 6/6.5 percent.

Miss KAPTUR. You also encourage more competitive third-party bidding at foreclosure sales.

Mr. LUKE. Right.

Miss KAPTUR. How would you do this?

Mr. LUKE. Again, as I responded to an earlier question, the minimum bid that VA sets on the properties at foreclosure needs to be in line with what VA has actually experiences over time in selling these properties. Right now, those two figures are out of line. The higher the bid floor is, the smaller number of bidders you are apt to get. When you bring the bid price down; you begin to increase the number of bidders. The more players you have the greater likelihood of moving properties to third-party bidders.

Miss KAPTUR. One of the other items I wanted to mention was that you stated that the VA should aggressively seek deeds in lieu of foreclosure. Could you expand on that recommendation, please?

Mr. LUKE. As Congressman Smith so aptly recognized, once you go into foreclosure, you begin to accrue costs as long as you are in the foreclosure process. So VA's objective should be to minimize that cost. One way to not incur the cost is to accept the deed in lieu of going through the foreclosure process, so the foreclosure process is never started. The vet conveys a deed, and VA relieves the vet of the debt.

Miss KAPTUR. And you save money.

Mr. LUKE. Absolutely, again, by not incurring some foreclosure costs.

Miss KAPTUR. Could you give us an idea of the characteristics of those properties that were left with lenders compared with properties that the VA acquired? Is there any appreciable difference from what you were able to see?

Mr. TONER. Looking at the Veterans' Administration data and comparing it, we saw that the average original value of those properties was about 30 percent higher than the properties that the VA took. The guaranty was substantially less. The guaranty was in the neighborhood of 40 percent rather than the norm of 50 percent. It took about 24 percent longer to foreclose on property left with the lender. The loan went into default considerably earlier than on property that VA acquired; and a substantial amount of the original value was lost by the time of foreclosure; in the neighborhood of $11,000 was lost between the original value and the foreclosure value.

Miss KAPTUR. What does all that mean?

Mr. LUKE. Let me try, Dave.

Mr. TONER. Okay.

Mr. LUKE. What all that means to me is that as the property value decreases over time, the less willing VA is to take that property and the less likely the lender is looking forward to taking that property. So in the no bid calculation, the bigger the gap between the indebtedness and the value of the property, the more likely the property will be left with the lenders.

Miss KAPTUR. Based on your figures, do you also know the number of properties left with lenders on a geographic basis? Are they concentrated in the energy belt, or is it all over the country?

Mr. LUKE. As indicated earlier, five of VA's offices—Houston, Los Angeles, Denver, Cleveland, Chicago, had 14,700 foreclosures during fiscal year 1986, which is roughly 42 percent of all foreclosures. They also represent roughly—

Miss KAPTUR. 42 percent?

Mr. LUKE. 42 percent of all foreclosures.

In these areas 2,878 properties were left with lenders, roughly 55 percent of all no bids during the year.

In terms of States, in Texas, California, Colorado, Illinois, Ohio, had close to 16,000 foreclosures representing 46 percent of all foreclosures. Those five States represent roughly 54/55 percent of all no bids—properties left with lenders.

So you can see geographically foreclosures and no bids have a very high concentration in a few areas.

Miss KAPTUR. That being attributable to the economy largely?

Mr. LUKE. In part, particularly, in Houston and Denver. I think it is more a function of the price of housing in Los Angeles than it is the economy.

Miss KAPTUR. That is interesting. The subcommittee has been looking at where to hold Field hearings. What we ought to do is just track those States and find the mid point somewhere in between them and see how much money we can save the taxpayers by holding the hearing there.

Could I ask you a judgment question, all of you gentlemen? As you got into this study and the report, you went around and you talked to the various officers of the VA, what surprised you the most? What findings or what procedures were there where, if you

had been in charge, you would have changed? You can either summarize something from your testimony or just speak more freely.

Mr. LUKE. Dave, I guess you were out there the most. Do you want to try?

Mr. TONER. What I would change the most is to get the people to be more aggressive on servicing. My initial contacts were with the Philadelphia and Pittsburgh office, and I saw how the VA operation worked there. I was very much impressed with that operation. I basically assumed that that was how the VA operation was working, but when I went to other offices I did not find that type of aggressive servicing. It is a function of the office. The system allows it to be done.

Miss KAPTUR. Do any of the other witnesses have any comments they wish to make?

Mr. LUKE. I would agree with that. As I indicated earlier, the key to this thing seems to be on the servicing side, and servicing is a function of how aggressive you are in terms of pursuing some of the assistance opportunities you have available to you and some of the programs that you have available to you to assist the veteran.

Miss KAPTUR. Do any of the other members of the committee have follow-up questions?

Mr. SMITH OF NEW HAMPSHIRE. One follow-up question, Madam Chairman.

Miss KAPTUR. Mr. Smith.

Mr. SMITH OF NEW HAMPSHIRE. On the servicing end again—I keep bugging you on the servicing end.

Mr. LUKE. It's important.

Mr. SMITH OF NEW HAMPSHIRE. You refer on page 6 of your testimony, under assisting veterans to sell their homes, to a program. Specifically, you say, "VA has a program under which it may provide in exchange for a promissory note to the veteran the financial assistance necessary to enable the veteran to sell his home." What program? How would you do that? How does that work? Where do the funds come from? In other words, you are taking a promissory note from the veteran and providing that veteran x number of dollars to promote the sale of his home, I'm assuming.

Mr. LUKE. Right.

Mr. SMITH OF NEW HAMPSHIRE. Is there some statute governing that? I don't see how that can be done. Is there a limit on it, and what does that entail? It seems to me that is a pretty far-reaching—I understand the intent is excellent, but it could get pretty murky here in terms of what is the magnitude.

Mr. TONER. It is our understanding that it is reflecting the loan guaranty fund. It is part of a loan guaranty fund. The claim that is paid comes out of the loan guaranty fund. It would be similar to a claim paid on a foreclosure.

Mr. SMITH OF NEW HAMPSHIRE. Yes, that is counsel's concern, too. Is there any statutory authority for that? That's my concern. I don't know of any, but that doesn't mean it isn't there.

Mr. LUKE. In our review of the program, we are not aware of any specific statute. That is one thing we could research for you and provide it for the record, if that is appropriate.

Mr. SMITH OF NEW HAMPSHIRE. My only concern in bringing it up is, it might be one of the areas where you are talking about run-

ning up costs. This could be one that may be contributing, with good intention on the part of the VA, but perhaps contributing to the costs. Assuming a veteran spends $5,000 to sell his home, or whatever, and doesn't sell it, then that adds to the tab. I don't know the specifics.

Mr. LUKE. Yes. Like I said, we don't know the specifics of the legal basis of the program, but we can say, that it is one of the programs or options, VA has available to it in terms of servicing the vet. It is also one of those that it has not chosen to use very frequently throughout the country.

Mr. SMITH OF NEW HAMPSHIRE. Thank you.

Thank you, Madam Chairman.

Miss KAPTUR. I think several members of the committee, the counsel, including myself, are fairly unfamiliar with this program, uncertain of the statutory authority for it and how it functions.

Mr. LUKE. Let us do some research.

Miss KAPTUR. All right. We would certainly appreciate that.

Let me thank all of you gentlemen on behalf of the committee. Thank you for your enlightening testimony. We do intend to follow up. We are very concerned about the servicing aspect. It is going to be one of the major sections of our bill when it is drafted, and you will make a contribution to that.

I would like to also submit Congressman Dan Burton's full statement for the record. He could not be with us here today, but I know he is equally interested in this discussion and will be given your testimony.

[The statement of Mr. Burton appears on p. 40.]

Miss KAPTUR. If you would permit us to also send to you questions he might have, to submit for the record, we would appreciate your reply to those as well.

Mr. LUKE. Sure.

[The questions and answers appear on p. 53.]

Miss KAPTUR. So thank you very much on behalf of the entire committee and for serving our country. You are going to help us figure out how to save money, too, and serve the veteran at the same time.

Mr. LUKE. Thank you, Madam Chairman.

Miss KAPTUR. Thank you very much.

The committee is adjourned.

[Whereupon, at 2:20 p.m., the subcommittee was adjourned.]

APPENDIX

United States General Accounting Office

GAO Testimony

For Release
on Delivery
Expected at
1:00 p.m. EDT
Wednesday,
May 11, 1987

VA's Home Loan Guaranty Program

Statement of
John H. Luke, Associate Director
Resources, Community, and Economic
Development Division

Before the
Subcommittee on Housing and
Memorial Affairs
Committee on Veterans' Affairs
House of Representatives

GAO/T-RCED-87-24

Madam Chairwoman and Members of the Subcommittee: We appreciate this opportunity to provide information on the Veterans Administration's (VA's) Home Loan Guaranty Program. As you are aware, on November 11, 1986, the Chairman of the Veterans' Affairs Committee asked us to

-- determine the impact of the Deficit Reduction Act of 1984 on the program,

-- evaluate VA's servicing of defaulted loans, and

-- determine whether VA's property acquisition and disposition process can be improved to reduce program costs.

In doing so, it was requested that we pay particular attention to VA's program in Houston, Texas, because of the depressed housing market and the substantial number of VA foreclosures in that area.

In summary, our review to date indicates that VA has reduced its losses, as the Deficit Reduction Act intended, by leaving more properties and potential losses with lenders. However, the debt of veterans who default on their loans has increased.

The extent of servicing (loan counseling and financial assistance) provided to veterans varied among the offices we visited and none of the offices voluntarily notified veterans of all the financial assistance options available to cure their defaulted loans. Some offices said they did not have adequate staff to provide effective assistance and our review shows that VA does not have a system to determine the number of delinquent loans that can be effectively handled by its servicing technicians.

We found that VA can improve its acquisition practices to reduce losses by avoiding unnecessary delays in acquiring property, encouraging additional bidding at foreclosure sales, and reducing

the costs of obtaining title policies on acquired property. In fiscal year 1986, VA sold nearly 25,000 acquired properties at a loss of about $356 million.

As I previously mentioned, Houston has a depressed housing market, and a substantial number of foreclosures. Nonetheless, we found little evidence that the Houston office had provided adequate loan servicing to prevent foreclosures. Since January 1987, this office has increased the number of personnel assigned to loan servicing and believes it will do a better job in assisting veterans to avoid foreclosure.

To accomplish our review objectives, we conducted interviews with loan guaranty officials at seven VA regional offices and at VA headquarters. We also reviewed property management and loan servicing records and files and met with Federal Housing Administration (FHA) officials and mortgage bankers to discuss their foreclosure practices. Before discussing our tentative findings, let me briefly highlight the VA program and its associated foreclosure processes.

The VA Home Loan Guaranty Program was established by The Serviceman's Readjustment Act of 1944 to assist returning veterans in obtaining housing as compensation for the lost opportunity experienced during their period of military service. The VA is authorized to aid the veteran in obtaining a home by requiring no down payment, providing low interest rates, and guaranteeing the home loan. The current amount of guaranty is limited to the lesser of $27,500 or 60 percent of the loan amount. As of September 30, 1986, VA had guaranteed about 11.8 million home loans since the inception of the program and about 4.1 million loans were outstanding.

During fiscal year 1986, lenders foreclosed on over 33,000 VA-guaranteed loans. (See exhibit I.) When a veteran defaults on a loan, VA must decide whether to acquire the property. Prior to the Deficit Reduction Act of 1984, VA, in making this decision, was not required to include certain post-acquisition costs, including repairs, maintenance, security, and taxes. The act, however, required VA to include these costs and limit its losses to the guaranty amount. If VA determines its losses would be more than the guaranty, it simply pays the guaranty and leaves the property with the lender. If VA decides to acquire the property, it attempts to purchase the property for the minimal cost, prepare and list the property for sale as quickly as possible, and sell the property for the best possible price. Madam Chairwoman, now I will discuss the effects of the Deficit Reduction Act.

EFFECTS OF THE DEFICIT REDUCTION ACT OF 1984

Our review shows that the Deficit Reduction Act has resulted in an increase in the debt of veterans who default on their loans. The veteran's debt is calculated based on the amount of indebtedness owed the lender, minus the estimated net value of the property. Because the act required post-acquisition costs to be included in VA's acquisition decision, the net value of the veteran's property has decreased, resulting in an average increase of $2,700 in the veteran's debt.

The act has also resulted in an increase in properties left with lenders. In fiscal year 1986, VA left 5,236 properties with lenders, an increase of 3,735 over the number left in fiscal year 1984. (See exhibit II.)

The results of a Mortgage Bankers Association survey showed that the average loss on properties left with lenders was about $16,500 during fiscal year 1986. Data provided by VA showed that it anticipated transferring an average loss of $3,750 on property

it did not acquire. (See exhibit III.) In asking the Mortgage Bankers Association about this difference, we were told that its estimated losses were not based on a scientific sample and included interest costs that VA does not include in its calculation. Further, our analysis of the Association's data showed that the average value of sampled properties included in the survey was about $43,000 higher than the average value of properties on which VA based its estimate. The higher valued properties generally have a greater potential for loss to the lenders because of the limit on VA's guarantee.

MORTGAGE SERVICING

Under VA's Home Loan Guaranty Program, mortgage lenders are required to service their VA loans by providing veterans with adequate opportunity to avoid foreclosure. However, the lender reports the delinquency to VA once the veteran has failed to make three payments on the mortgage loan. VA then takes an active role in protecting the financial interests of the veteran and the government by attempting to cure the delinquency.

We found that the extent of loan servicing varies widely among VA's regional offices. For example, in two of the offices we visited, attempts were made to contact each veteran to determine whether a loan repayment plan could be developed to cure the delinquency. At three of the other offices, however, we were told that the number of staff was inadequate to effectively contact, counsel, and assist the large number of veterans having delinquent loans. The number of delinquent loans handled by servicing technicians at the offices we visited ranged from 400 to 1500 loans. VA does not have a system to determine the number of delinquent loans that can be effectively handled by its servicing technicians.

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According to VA regional officials, they encourage veterans to reach agreement with lenders on how to cure the loans. However, VA usually does not provide information on financial assistance options which VA can provide, unless the veteran is aware of and requests information on these options. VA's financial assistance options include (1) encouraging the lender to reduce the interest rate of the loan, (2) refunding the loan, and (3) assisting the veteran to avoid foreclosure by selling the property. We were told by the Assistant Director for Loan Management that VA has not informed veterans of the latter two options because they might not attempt to cure their loans by reaching repayment agreements with mortgage lenders.

Reducing the interest rate

Many of VA's delinquent loans were made during the high interest rate period of 1982 to 1984. Therefore, an option that VA can sometimes use to cure loans is to encourage the lender to refinance the loans at lower interest rates. Refinancing would provide some veterans with a lower monthly payment, thus increasing their likelihood of staying in the home. However, the VA is not contacting all veterans with delinquent loans to make an assessment on the feasibility of refinancing; accordingly, this option is not being fully utilized.

Refunding

When lenders will not refinance delinquent loans, VA may pay the lender the outstanding loan amount as an option to foreclosure, enabling the veteran to keep the property. VA then "refunds" the loan and establishes a repayment plan based on the veteran's ability to repay the loan. In effect, VA assumes the role of the lender.

The average cost avoidance possible through refunding in fiscal year 1986 was $14,400 per property. This is based on the average amount of loss that VA incurred on the sale of acquired properties. Our analysis shows that the cost avoidance from one successful refunded loan would be sufficient to offset the additional foreclosure costs to refund six loans that subsequently fail. (See exhibit IV.) According to VA's Assistant Director of Loan Management, refunding has been successful in about 50 percent of the cases in which it has been used. Nonetheless, during fiscal year 1986, VA refunded only one mortgage for every 129 foreclosures.

Assisting veterans to sell their homes

As an alternative to foreclosure, veterans may sell their homes and pay their outstanding loan balances. However, they sometimes need financial assistance to do this because the proceeds from the sale are not adequate to pay both the outstanding loan balance and the selling expenses. VA has a program under which it may provide, in exchange for a promissory note from the veteran, the financial assistance necessary to enable the veteran to sell the property. VA provides this assistance when it believes it is cost effective to do so because the veteran can obtain the fair market value for the property and VA can avoid foreclosure costs. Again, however, VA does not generally inform veterans that this option is available to them.

VA's ACQUISITION AND DISPOSITION PROCESS

When VA decides that it is in the best interests of the government to acquire a property, it should minimize its acquisition costs. In fiscal year 1986, VA lost an average of about $14,400 on the properties it sold. Our review indicates that VA can reduce its losses by (1) seeking to obtain more "voluntary

deeds" from veterans in lieu of lengthy and expensive foreclosure actions, (2) encouraging more competitive "third party" bidding at foreclosure sales, and (3) reducing its costs for title insurance policies when it acquires property from lenders.

Voluntary deed in lieu of foreclosure

Voluntary deed conveyance is an expeditious means of terminating a delinquent loan. The veteran voluntarily conveys the property deed and is released from liability to repay the government for any claim VA pays as a result of the loan termination. In so doing, the foreclosure process is avoided and VA is able to acquire the property more quickly and avoid costs, including interest, taxes, and legal expenses.

In fiscal year 1985, VA acquired about 7 percent of its properties by voluntary deed. A report issued in September 1986 by the VA Inspector General estimated that, by more aggressively seeking deeds in lieu of foreclosure, VA could have acquired about 20 percent of the properties through voluntary deeds during fiscal year 1985. The Inspector General estimated that this would have saved VA about $16 million in acquisition costs, or about $5,300 per property.

We found that VA acquired only about 6 percent of properties through voluntary deeds during fiscal year 1986. In performing our review, we noted that VA generally does not accept a voluntary deed if it believes that it can collect from the veteran the amount of the claim VA pays the lender as a result of the loan termination. However, at one of the offices we visited, voluntary deeds were accepted if veterans were willing to sign a promissory note to repay the claim. VA should determine whether it is feasible to use this practice in other offices as a means for reducing the debt of veterans and avoiding the considerable expenses associated with foreclosures.

Third-party bidding

VA's acquisition costs could potentially be reduced if more third parties (individuals other than lenders) made successful bids at foreclosure sales. When third parties purchase the property, VA pays the lender the difference between the total indebtedness and the bid price, and avoids both acquisition and post-acquisition costs. We noted, however, that only about 5 percent of foreclosed properties were acquired by third parties during fiscal year 1986.

To increase third party bidding, VA could establish a minimum bid amount that reflects the net amount that VA expects to realize on the sale of property. We found that the minimum bid amount often exceeds the net amount VA realizes when it sells the property. This difference could then be factored into each office's determination of the minimum bid amount to encourage third-party bidding.

Title insurance

When VA acquires property, it requires lenders to provide it with assurance of good and marketable title to the property. In April 1986 VA instructed its field offices to obtain title insurance policies from title companies, rather than continuing to analyze title documentation to assure that lenders were providing good and marketable title.

VA decided to obtain title insurance policies, which generally cost several hundred dollars each, because it believed their use would expedite the property-acquisition process. Based on our review, however, title policies have not reduced the time needed to complete the acquisition process. Now, VA officials are considering eliminating the requirement for title insurance policies since they are not achieving their anticipated purpose of expediting property acquisitions.

We concur with VA's decision to reconsider whether to require the purchase of title policies. Further, in the event that VA decides to continue purchasing the policies, it could still reduce its costs by purchasing them for the lowest possible cost. For example, the minimum title policy in Pennsylvania costs $263 for $15,000 worth of insurance. However, in fiscal year 1986, VA insured the average property in Pennsylvania for $27,000, the appraised value of the property, at a cost of $353.

VA'S RESPONSE TO HOUSTON'S DEPRESSED HOUSING MARKET

As noted earlier, we were asked to review VA's response to the depressed housing market in the Houston area. As you are aware, this area suffers from unemployment due to cutbacks in the oil industry, a high home vacancy rate, and a foreclosure rate among the highest in the country.

In fiscal year 1984, before the Deficit Reduction Act took effect, the Houston office handled 1,944 foreclosures, leaving only 4 properties with lenders. In contrast, in fiscal year 1986 that office handled over 5,600 foreclosures, leaving nearly 1,100 of the properties with lenders.

Our review showed that some of these properties were left with the lenders because VA's Houston office, for a period of 8 months in 1986, adjusted upward the calculation that VA uses throughout the country to decide whether to acquire foreclosed property. The adjusted calculation increased VA's estimate of its costs to reflect declining property values in the Houston area. VA's estimate of its costs was increased by an average of $2,225 per property during the 8-month period.

The adjustment also increased the debt of veterans who lost their homes because their debt is based on VA's property acquisition calculation. On the basis of our analysis of VA's data, the average debt was increased by an estimated 22 percent, from about $9,900 to $12,100 on properties acquired by VA.

In an attempt to determine the impact of Houston's adjusted calculation on mortgage lenders, we analyzed the 135 properties left with lenders during a 2-week period in September 1986. We found that 37 properties, or over 27 percent, would have been acquired by VA if the calculation had not been adjusted. In October 1986, VA headquarters instructed the Houston office to resume using the national calculation in making acquisition decisions.

Because of difficulty in selling its large inventory of acquired property, the Houston office used auction sales to sell property that had been in its inventory for more than a year. During 1986, the office used three auction sales to dispose of property at substantial losses. For example, in one of the auctions, the average property was sold for 44 percent of VA's initial sales price.

While this method of disposing of inventories may have achieved VA's goal of reducing the number of properties in its inventory, the Mortgage Bankers Association told us it is concerned about the effect of VA auctions on home values in the Houston area. VA's Assistant Director of Property Management told us that VA plans to continue using auction sales to effectively compete in selling property in the Houston area.

We noted that competition between VA and FHA may also be influencing the decline of property values because these agencies collectively hold over 10,000 foreclosed properties in the Houston area. During 1986, VA lowered its prices by 10 percent to compete

with FHA's prices. FHA responded by lowering its prices by another 10 percent and, at the time of our review, VA was considering once again lowering its prices in response to FHA's reduction.

We also reviewed the servicing performed by the Houston office and found little evidence that it had provided financial counseling and assistance to prevent foreclosures. In the last quarter of fiscal year 1986, the Houston office had made personal contact with less than 28 percent of the homeowners involved in foreclosures during that quarter. Further, the Houston office refunded only seven loans, while lenders foreclosed on more than 5,600 mortgages during fiscal year 1986.

In January 1987, VA approved ten additional staff members for the Houston Loan Guaranty Division. Three of these staff members were assigned to loan servicing, doubling the number of servicing technicians at the office. According to the loan servicing chief in Houston, the office will now be able to do a better job of assisting veterans to keep their property. She said, however, that an additional three staff members are still needed to effectively service the office's delinquent loans.

Nonetheless, we noted that the office is making progress in providing financial assistance. Since October 1986, it has refunded four loans and is in the process of refunding 28 loans. The Director of the Houston office told us that, with the additional staff members that have been assigned, the office can now encourage refunding as an option to foreclosure.

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In closing, Madam Chairwoman, we would like to reemphasize that VA's Home Loan Guaranty Program is experiencing a large number of foreclosures. The foreclosure process is costly for VA, the veteran, and sometimes the lender, particularly in depressed

housing markets. Since the Deficit Reduction Act of 1984 has been implemented, VA appears to have accomplished the broad intent of the act by minimizing its losses within the guaranty amount. However, this has increased the debt of veterans who default on their loans, and the losses of lenders who participate in the program. To help reduce these costs, more emphasis should be placed on servicing to prevent foreclosure. Once foreclosure is evident, VA should try to minimize the cost of acquisition.

Madam Chairwoman, I have highlighted today some areas in which VA can improve its Home Loan Guaranty Program based on our preliminary findings. We are planning to complete our work and issue a report to the Chairman of the House Veterans' Affairs Committee containing our conclusions on the areas we have discussed.

Madam Chairwoman, this concludes my prepared remarks. I will be happy to respond to any questions you may have at this time.

EXHIBIT I

VA FORECLOSURE ACTIONS AND LOSSES

	FY 1984	FY 1985	FY 1986
Number of foreclosures	23,377	27,276	33,022
Number of voluntary conveyances	2,178	1,728	1,620
Number of properties left with lenders	1,501	3,059	5,236
Number of refundings	565	635	256
Average loss on acquired property	$10,784	$14,715	$14,391
Average loss[a]	$11,186	$15,216	$15,258

[a]Includes claims paid by VA for properties left with lenders.

Source: Veterans Administration
Prepared by the General Accounting Office, May 1987

EXHIBIT II

VA FORECLOSURE ACTIONS AND NUMBER OF PROPERTIES LEFT WITH LENDERS

Fiscal year	Foreclosure actions[a]	Number of properties left with lenders	Number of properties left as percentage of total foreclosure actions
1981	13,729	358	2.61
1962	17,071	238	1.39
1983	23,349	689	2.95
1984	25,555	1,501	5.87
1985	29,004	3,059	10.55
1986	34,642	5,236	15.11

[a]Includes voluntary conveyances

Source: Veterans Administration
Prepared by the General Accounting Office, May 1987

EXHIBIT III

EXAMPLE OF DECISION TO LEAVE THE PROPERTY
WITH THE LENDER AND PAY THE GUARANTY

Total indebtedness		$93,900
Appraised value	$70,000	
Minus holding costs @ 10.5%	7,350	
Estimated net VA value		62,650
Loss		$31,250
Maximum VA guaranty amount		27,500
Loss transferred to lender		$ 3,750

Because the estimated loss of $31,250 is more than the maximum guaranty amount of $27,500, VA would not acquire this property. If VA had acquired the property, it would lose $3,750 above the guaranty amount. By not acquiring the property, VA transfers the $3,750 loss to the lender.

EXHIBIT IV

ANALYSIS OF THE INCREMENTAL COST ASSOCIATED WITH A REFUNDING FAILURE

Average monthly payment of a refunded loan		$544 [a]
Average number of months between default and the lender's notice of intention to foreclose	3.4	
Refunding decision period (months)	1.0	
Total [b]		4.4 months
Average loss if a refunded mortgage failed (4.4 x $544)		$ 2,394
Average foreclosure loss on property acquired in fiscal year 1986		$14,391
Success-to-failure ratio ($14,391 to $2,394)		1 to 6

[a] Average acquisition value in fiscal year 1986 ($53,883) at 9 1/2 percent for 30 years and the average monthly tax payment.

[b] According to the provisions of 38 C.F.R. 36.4318 the refunding decision should be made within 30 days after the lender has notified VA of its intention to foreclose or unless other arrangements have been made with the lender.

MADAM CHAIRWOMAN

OVER THE LAST SEVERAL MONTHS THIS SUBCOMMITTEE HAS LISTENED TO A VARIETY OF WITNESSES WHO HAVE GIVEN US THEIR SUGGESTIONS FOR IMPROVING THE VETERAN'S ADMINISTRATION GUARANTEED HOME LOAN PROGRAM. ONCE AGAIN, WE WELCOME THE ADDITIONAL INPUT.

WE CAN ALL APPRECIATE

THE SUCCESS OF THE HOME LOAN GUARANTY PROGRAM, BUT WE CANNOT OVERLOOK ATTEMPTS TO IMPROVE IT. WE HAVE SHOWN IN THE PAST, AND I CAN ASSURE YOU FOR THE FUTURE, THAT ALL OF OUR EFFORTS ARE IN THE BEST INTEREST OF THE VETERAN.

WHILE THIS PROGRAM CONTINUES TO BE SUCCESSFUL WE CANNOT OVERLOOK THE HIGH FORECLOSURE RATE AND SHRINKING REVOLVING FUND. SO, I LOOK

FORWARD TO HEARING FROM MR. JOHN LUKE. HOPEFULLY, WE CAN INCORPORATE THE FINDINGS OF THE GAO STUDY INTO VIABLE OPPORTUNITIES TO IMPROVE THE HOME LOAN GUARANTY PROGRAM.

THANK YOU.

GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

JUN 18 1987

The Honorable Marcy Kaptur, Chairwoman
Subcommittee on Housing and Memorial
Affairs
Committee on Veterans' Affairs
House of Representatives

Dear Madam Chairwoman:

This letter is in response to your May 21, 1987, request that we answer questions submitted by the Honorable Dan Burton based on our May 13, 1987, testimony on the Veterans Administration's (VA) Home Loan Guaranty Program. Enclosure I provides our answers to each of the eight questions raised by Congressman Burton.

Additionally, during the Subcommittee's May 13, 1987, hearings, you requested that we provide information on (1) the total cost savings available to VA by taking actions to improve loan servicing and other methods of handling delinquent loans and (2) the statutory authority for VA's compromise sales program. Based on discussions with your office, we are providing this additional information in enclosure II to this letter.

I hope that the enclosed information will be useful to the Subcommittee in its deliberations on VA's Home Loan Guaranty Program. Please let me know if we can be of further assistance.

Sincerely yours,

John H. Luke

John H. Luke
Associate Director

Enclosures (2)

ENCLOSURE I

ENCLOSURE I

QUESTIONS OF THE HONORABLE DAN BURTON OF INDIANA
SUBCOMMITTEE ON HOUSING AND MEMORIAL AFFAIRS
MAY 13, 1987

Question 1: In your opinion, is it counterproductive to not service loans adequately? In other words, would the government have substantially fewer losses if it had more servicing technicians?

GAO Response

The purpose of servicing is to try to prevent foreclosure. As stated in our testimony, foreclosure is a costly experience for VA, the veteran, and sometimes the lender. If foreclosure can be prevented, it reduces the cost for all parties involved. If VA were more actively involved in servicing during the default/foreclosure process, it would be in a better position to (1) obtain financial assistance from the lender for the delinquent homeowner, (2) obtain deeds-in-lieu of foreclosure, (3) negotiate compromise sales, and (4) obtain data needed to make a refunding decision. All of these actions have the potential for significant savings to the loan guaranty fund. Therefore, we believe it is productive for VA to have an effective servicing effort to help reduce the high rate of foreclosures.

We did not fully evaluate the adequacy of staffing for VA's servicing function, but at three of the seven offices we visited, we were told by VA officials that there was not an adequate number of staff to effectively contact, counsel, and assist the large number of veterans having delinquent loans. Based on the scope and objectives of our review of VA's servicing system, we were not able to determine whether there is a statistical correlation between the personal contacts made by VA offices and the cure rate on delinquent loans. However, as shown in the table on page 2, at the VA offices we visited we noted that those which had the highest rates of personal contact also had the highest cure rates.

ENCLOSURE I ENCLOSURE I

Table 1

PERSONAL CONTACT AND CURE RATE

VA office	Period	Personal contact rate[b] (percent)	Cure rate (percent)
Philadelphia	Oct. 85--Dec. 86	83	89.2
Pittsburgh	Jan. 86--June 86 & Oct. 86--Dec. 86[a]	66[c]	81.0
Detroit	Oct. 85--Sep. 86	76	77.8
Portland	Oct. 85--Dec. 86	70	68.8
Denver	Apr. 86--Mar. 87	61	65.5
Seattle	Oct. 85--June 86 & Oct. 86--Dec. 86[a]	60	60.0
Houston	Oct. 85--Sep. 86	33	54.5

[a]Data was not available for July through September 1986.

[b]Telephone, financial counseling, field visit, or office visit.

[c]Our review showed that VA's Pittsburgh Office was attempting to personally contact each delinquent homeowner. According to the loan servicing supervisor, the personal contact rate indicated above should have been much higher because one servicing technician was not coding his contacts into the computer system.

Source: Prepared by the General Accounting Office using VA data, May 1987

Question 2: In your opinion, does the VA auction program, such as the one in Houston, Texas, adversely affect home values as suggested by mortgage bankers?

GAO Response

We did not analyze the effect of auction sales in Houston or other parts of the country, but we did note that VA primarily uses auction sales as a last resort technique for disposing of hard-to-sell properties which have been in its inventory for 12 months or longer. The use of auctions for this purpose does not appear to be a problem nationwide. However, when auctions are used in a depressed housing market like Houston, there is the potential that they could create or further add to the crisis situation that develops when there is a substantial decline in property values.

We should also point out that VA was not the only large property holder using auctions in Houston. For example, both the Federal Housing Adminstration and the Federal National Mortgage Association used auctions to dispose of their property.

ENCLOSURE I

Question 3: Why does VA not obtain title policies at the best possible price?

GAO Response

VA requires lenders to purchase title insurance policies not for the insurance they provide but as a means of documenting that good and marketable titles are being passed to VA. VA reimburses the lenders for the costs of the policies.

The costs of the policies vary, depending on the amount of insurance they provide. The least expensive policies carry only a minimal amount of insurance. These are the most appropriate policies for VA, since VA buys the policies to document that it has good and marketable title to the property, not to protect itself with insurance against a defect in the title.

We found, however, that lenders generally purchase, and are reimbursed for, more expensive policies which provide enough insurance to cover the appraised value of the property less the anticipated post acquisition costs. Consequently, if VA decides to continue requiring lenders to obtain title policies, it can reduce its costs by having the lenders purchase the policies offering a minimal amount of insurance and the lowest cost.

Question 4: Didn't VA have a policy sometime ago of not acquiring title insurance on foreclosed properties?

GAO Response

Yes. Prior to April 1986, VA field offices were not required to obtain title policies. Instead, they analyzed title documentation to assure that lenders were providing good and marketable title.

 ENCLOSURE I

Question 5: What are the guidelines on refunding of loans and are they applied uniformly by regional offices?

GAO Response

Refunding guidance is contained in VA's manual on Loan Management and Servicing Policies, Procedures and Methods, which states the following criteria:

> Refunding to Avoid Liquidation. A decision to refund will require due consideration of all pertinent factors, including those developed through personal servicing by the holder and VA. A loan will be considered eligible for refunding when it is determined that:
>
> (1) The holder is unwilling to grant further forbearance;
>
> (2) The veteran desires to retain and occupy the property;
>
> (3) The veteran has shown an ability to care for and maintain the property;
>
> (4) The veteran has a present or potential ability to satisfactorily resume regular payments within a reasonable time, and to repay the loan; and
>
> (5) The estimated net value of the property exceeds the unguaranteed portion of the loan.
>
> Equity Cases. When it is determined that there is substantial equity in the property, refunding should be considered to allow the veteran a further opportunity to reinstate the loan, or to sell the property and realize the equity.
>
> Special Cases. There will be cases that do not meet all the criteria specified above, but which should be refunded because it would be in the best interests of the Government to avoid acquisition of the properties. These would include cases in projects or areas where VA already owns a number of properties and the sales market is inactive, or it is anticipated that the particular property, whether located in a project or not, would be difficult to sell or would be saleable only for an amount substantially below VA's investment. In these cases, even though the payment record of the owner would not warrant indulgence, it may be in the interests of the Government to refund the loan provided there is some likelihood that the loan payments will be made by the borrower. In this connection an extension and reamortization of the loan may be warranted.

VA requires that each potential foreclosure case be evaluated to determine if refunding is appropriate. To do this, VA needs to know the reason for default and the homeowner's present and potential ability to resume regular mortgage payments. As pointed out in our testimony, several of the VA offices were not attempting to personally contact homeowners. Without such contact, it would be difficult for VA to determine if the homeowner qualified for refunding.

 ENCLOSURE I

Question 6: Referring to page 6 of your statement (1st paragraph), are you saying that in 50 percent of the refunding cases, the home went into foreclosure after VA refunded it?

GAO Response

According to VA's Assistant Director of Loan Management, an estimated 50 percent of refunding cases were subsequently foreclosed after refunding. He told us that VA's data on refunding cases is not maintained separately from its data on other loans. Therefore, VA does not know precisely how many refundings failed or the reasons they failed.

Question 7: How has VA's current system of leaving an increasing number of properties with lenders and paying off the guaranty been received by the lending industry? Have any lenders pulled out of the program because of this procedure?

GAO Response

The Mortgage Bankers Association of America has referred to this as the "darkest cloud hanging over the home loan guaranty program" and has set up several task forces to look at the problem. According to the Mortgage Bankers Association, in certain parts of the country, the number of properties being left with lenders has reached such levels that "lenders have begun to reassess their participation in the VA home-loan program."

Our discussions with individual mortgage companies disclosed various opinions concerning the problem. They ranged from those who did not consider it to be a great problem to those who considered it a crisis.

With regard to lenders discontinuing their involvement in the program, during our review we interviewed a few mortgage lenders in each of the seven offices we visited and only one had stopped originating VA guaranteed loans. Other lenders, however, had taken steps to minimize their exposure to VA's policy, such as adopting tighter underwriting standards and requiring downpayments.

Question 8: Did you find that VA services its vendee accounts sometimes almost to the exclusion of other houses guaranteed under the GI Loan Program?

GAO Response

VA relies heavily on lenders to effectively service the loan guaranty program and becomes actively involved only if the delinquency becomes severe. In contrast, VA is the lender on the vendee accounts and must provide primary servicing as soon as the account becomes delinquent. Additionally, VA is responsible for foreclosing on vendee accounts which cannot be cured, a responsibility of the lender under VA's loan guaranty program.

However, we noted that the two servicing functions do compete for servicing resources and it is the responsibility of the regional office loan guaranty officer to properly allocate these resources. For example, the Houston office had added several additional servicing technicians for the loan guaranty program but, at the time of our review, it was still handling considerably more delinquent accounts than any of the other six offices we visited. The loan servicing supervisor told us that if she received any additional technicians, she would assign them to servicing vendee accounts because this function was considerably understaffed and the delinquency rate was increasing.

ENCLOSURE II

ENCLOSURE II

QUESTIONS OF THE SUBCOMMITTEE ON HOUSING
AND MEMORIAL AFFAIRS
MAY 13, 1987

Question 1: What are the total cost savings available to VA by taking actions to improve its loan servicing and other methods for handling delinquent loans?

GAO Response

Our review indicates that VA can achieve cost savings by (1) improving the servicing of delinquent loans or by refunding loans, (2) obtaining more deeds-in-lieu of foreclosure, (3) increasing the use of the compromise sales program, (4) increasing third-party bidding, and (5) requiring lenders to give VA a general warranty deed rather than to obtain title policies. We cannot provide a reliable estimate of the total dollar savings available without performing a more detailed review of each of the above possible actions. However, as discussed below, the potential savings are substantial.

-- The number of foreclosures can be reduced by VA either refunding loans or more aggressively seeking relief for the homeowner from the lender through forbearance, refinancing, or modification of loan conditions. We estimate that VA could save $4.3 million for each 1 percent reduction in the foreclosure rate, based on foreclosure losses of $430 million in fiscal year 1986.

-- By obtaining additional deeds through voluntary deed conveyance, VA can expedite the termination of delinquent loans. A report issued in September 1986 by the VA Inspector General estimated that, by more aggressively seeking deeds in lieu of foreclosure, VA could have saved $16 million in acquisition costs during fiscal year 1985.

-- VA could reduce losses by more aggressively implementing its compromise sales program. The amount of the potential savings would depend on a number of variables such as the value of the property and the amount of time needed to sell it. We believe, however, that the potential savings to the government are significant. For example, assuming that VA lends a veteran $5,000 to enable him to sell his property and assuming a 7 percent interest rate, savings to the government would amount to about $2,360 by VA using the compromise sales program rather than acquiring a property for $50,000 and holding it for a 9-month period before selling it.

-- VA could reduce property acquisitions by encouraging more third-party bidding at foreclosure sales. Based on VA's foreclosure data for fiscal year 1987, we estimate that the government could save over $650,000 for each 1 percent reduction in the number of properties that VA acquires.

-- Based on VA's 27,786 property acquisitions during fiscal year 1986, we estimate that VA could reduce its annual acquisition costs by about $8.3 million by requiring lenders to give VA general warranty deeds rather than obtaining title policies.

Question 2: What is the statutory authority for VA's compromise sales program?

GAO Response

According to VA's manual on Loan Guaranty Operations for Regional Offices, the statutory authority for the compromise sales program is 38 U.S.C. 1820, which gives the VA Administrator broad discretion to pay or compromise any claim arising because of the VA guaranty. Amounts paid under the program are charged to the VA revolving fund.

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